

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Speier Analyst: LuAnna Hass Bill Number: SB 285

Related Bills: See Prior Analysis Telephone: 845-7478 Amended Date: June 18, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Relief From Joint And Several Liability On Joint Return

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended May 22, 2003.
- ☐ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended May 22, 2003.
- ☒ FURTHER AMENDMENTS NECESSARY.
- ☐ DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 22, 2003, STILL APPLIES.
- ☐ OTHER - See comments below.

SUMMARY

This bill would provide that if an individual receives relief from income tax liabilities under the federal innocent spouse provisions, that individual would also receive relief under the state innocent spouse provisions.

SUMMARY OF AMENDMENT

The June 18, 2003, amendments resolved the department's technical concerns by accepting the amendments suggested in the department's analysis of the bill as amended May 22, 2003.

Specifically, the amendments would:

- Clarify that the innocent spouse provisions as amended in this bill would cease to be operative as of January 1, 2009. At that point the current law innocent spouse provisions would be reinstated as of January 1, 2009. This amendment ensures that only one provision is operative on January 1, 2009.
- Correct the provision of the bill that would reinstate the current law innocent spouse provision as of January 1, 2009, to reflect the references to a 1999 act and it's effective date, which amended specific provisions of the innocent spouse law.

In addition, the amendments would require the Franchise Tax Board (FTB) to report to the Legislature the impact this bill has on requests for innocent spouse relief. The report would be due to the Legislature by January 1, 2008, and to the extent data is available to FTB, the report should include the total number and dollar value of 1) innocent spouse claims received each year; and 2) innocent spouse claims where FTB automatically deferred to the Internal Revenue Service (IRS) as provided in this bill.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director

Date

Brian Putler

6/23/03

For convenience, any existing concerns are provided below. The remainder of the department's analysis of the bill as amended May 22, 2003, still applies.

POSITION

Pending.

ANALYSIS

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- Current state law requires an individual seeking relief under the innocent spouse doctrine of a separate liability election, as discussed under "Federal/State Law," to request such relief within two years of the date FTB begins collection action with respect to the requesting spouse. Under this bill it is unclear if an individual who receives relief at the federal level through the separate liability election must still meet the two-year deadline for relief at the state level.
- This bill would provide an individual relief at the state level based on a federal determination. However, this bill does not provide FTB with the option to make a separate determination in instances where FTB discovers information that the federal determination is erroneous. FTB has access to numerous sources of taxpayer information and utilizes various on-line systems to investigate facts and verify statements made by the non-electing and electing spouses. Sources of information include credit reports, other state agency files (Employment Development Department, Board of Equalization, Secretary of State, Department of Motor Vehicles), various county records, and Lexis/Nexis.

ARGUMENTS/POLICY CONCERNS

Requiring the department to grant innocent spouse relief based on a federal determination would prevent the department from making a separate determination based on all the facts and circumstances available to the department. Such a requirement would effectively delegate the State's authority to make independent factual determinations in income tax matters to the IRS, which would be unprecedented.

Further, FTB would be required to grant relief on the basis of federal relief if the non-electing spouse *had an opportunity to participate* in the federal administrative or judicial proceeding that led to the granting of relief at the federal level. Generally, under federal law every non-requesting spouse has an opportunity to participate in innocent spouse proceedings. Therefore, the requesting spouse would be entitled to relief for state purposes and the non-requesting spouse would be denied the possibility of providing FTB information or participating in a state proceeding. The State's authority to make independent determinations in these instances would be delegated to the IRS. This problem could be minimized if the bill were amended to allow a non-requesting spouse to provide information indicating that he or she *did not participate* in the federal proceedings.

As discussed under "State/Federal Law," California law allows avenues for relief that are not available under federal law, including relief from joint and several liability through a divorce court order. It is possible that Spouse A could receive relief through a divorce court order and subsequently Spouse B requests and is granted innocent spouse relief at the federal level. Under this bill, if FTB were unable to make a separate determination, Spouse B would be entitled to state innocent spouse relief. As a result, neither spouse would be liable for the state income tax liability. The ability of Spouse B to gain relief under this bill could also be contrary to the California divorce court order that specified Spouse A was entitled to relief from the joint and several liability and Spouse B was not.

A spouse requesting relief under the state innocent spouse provisions must pay the tax on the income that they earned, managed, or controlled in order to qualify for relief. Often relief is denied for prior tax years where FTB records have been purged and the requesting individual is unable to verify tax was paid on their earned income for the year in question. Under this bill, if the IRS granted relief then FTB would be required to grant similar relief even though the department may be unsure or unable to verify that the requesting spouse has paid the appropriate share of tax.

This bill would allow FTB to make an independent determination of relief based on a federal determination if the non-electing spouse submits information showing 1) he or she did not have an opportunity to participate in the federal administrative or judicial proceeding that led to the granting of relief at the federal level; 2) the issues and liabilities were not the same; or 3) the requesting spouse was not entitled to federal innocent spouse relief. This would be contrary to the current statutory provision that requires the requesting spouse to prove his or her entitlement to relief. Consequently, the standard for innocent spouse relief in California would be different for applicants with a federal determination than it is for those that request relief without a federal determination.

Generally, FTB processes requests in less time than the IRS. On average, FTB provides a final determination within four to six months. In fiscal year 2001, it took the IRS an average of 12 months to process an innocent spouse case (GAO-02-588). Since the IRS determination is considered in FTB's investigation process, FTB's Innocent Spouse Program staff inquires about the electing spouse's IRS determination. Often the IRS determination is pending. Depending on the timing of the request for relief, the requesting spouse could receive a determination from FTB prior to receiving a federal determination.

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